

WWI to WWII Economics

We have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand.

—John Maynard Keynes (1930)

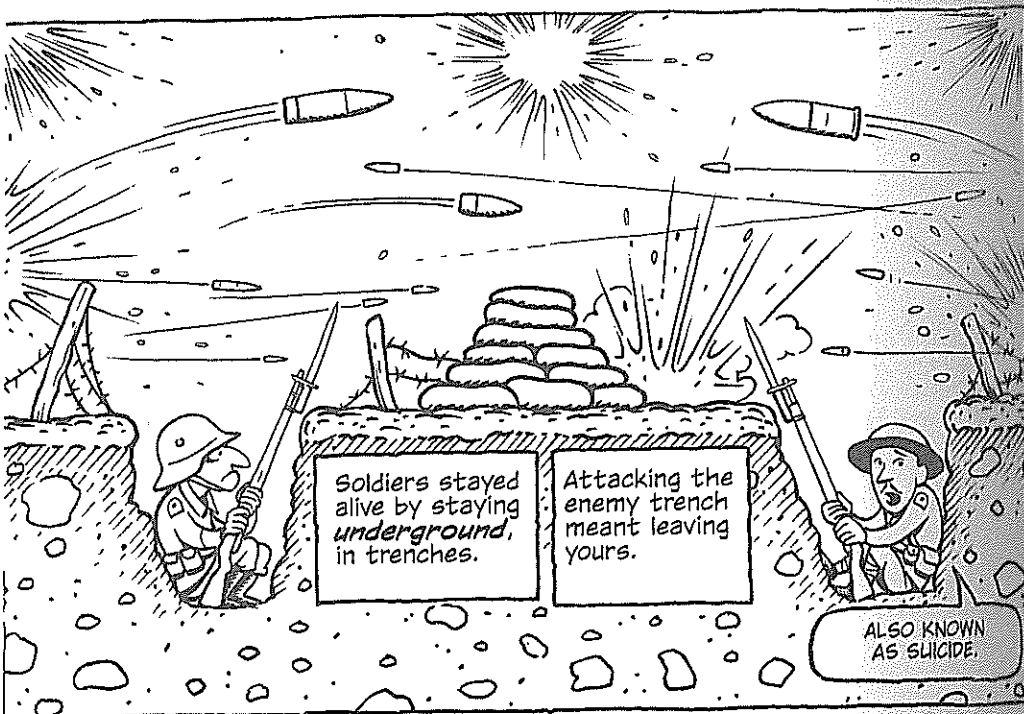
CHAPTER 4

THINGS FALL APART

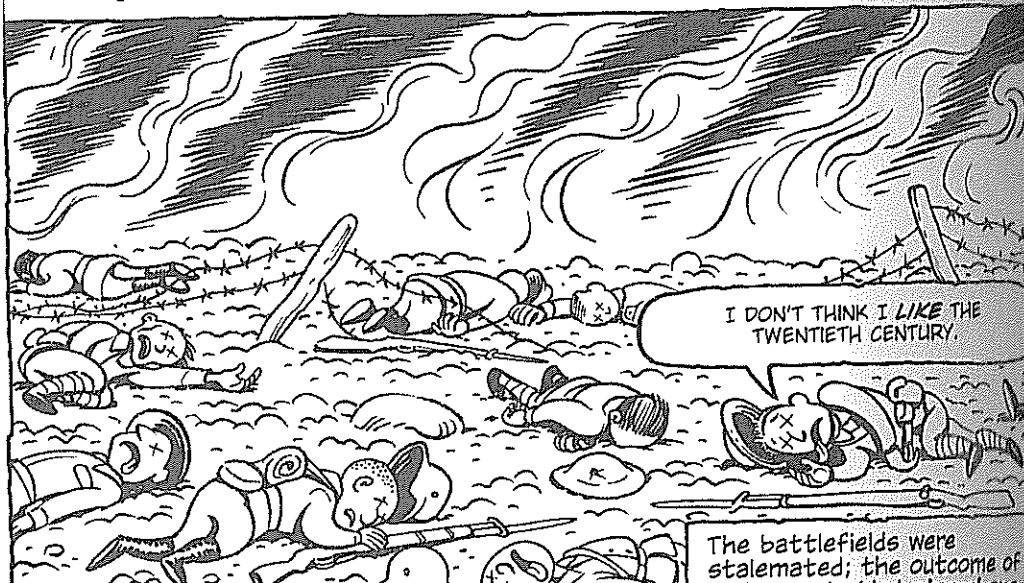
(1914–1945)



Mass-produced modern weapons made World War I battlefields not merely dangerous; they were *unfit for human life*.



The generals, safe in country estates, far from the slumlike trenches, kept ordering attacks. *Millions* of dead piled up.

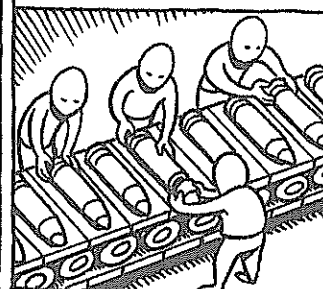
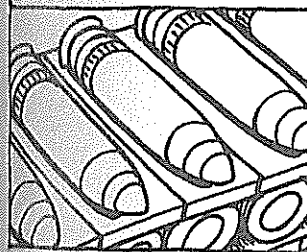


ECONOMIES AT WAR

An industrial war feeds on more than men; waging WWI required unprecedented amounts of bullets, shells, food, guns, trucks, clothing, airplanes, coal, gasoline, oil, tanks, and so on.

Both sides had to wring every last bit of effort out of the people making all that stuff at home. That meant a *war economy*.

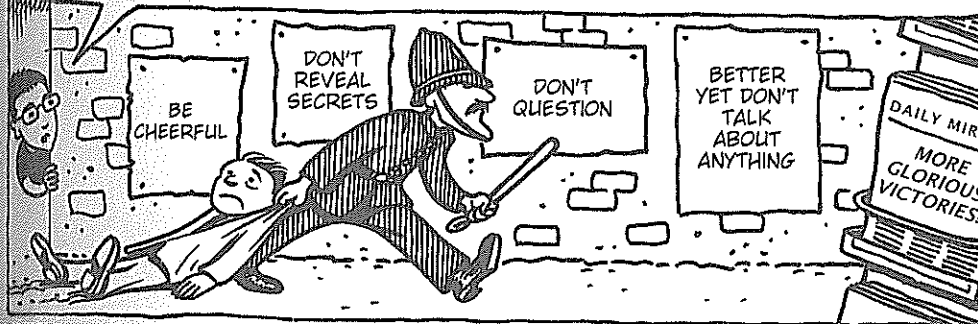
A war economy is a *command economy*: The government *allocates* resources, *dictates* what gets made, and *rations* necessities.



YOU'RE MOVING TO GLASGOW TO WORK IN A SHIPYARD.

WHATEVER HELPS!

A WAR ECONOMY LEADS TO THE NEED—OR PERCEIVED NEED—TO KEEP CIVILIAN WORKERS ENTHUSIASTIC. IN WORLD WAR I, GOVERNMENTS LEARNED THE WAYS OF *CENSORSHIP, PROPAGANDA, AND REPRESSION*.



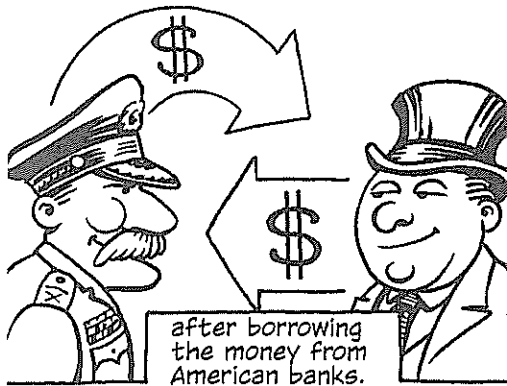
It also makes sense to strike *directly* at the enemy's economy. WWI saw the first use of *strategic bombing*.



An older but more effective way to hurt an enemy economy: *blockade*. German submarines pestered Allied trade, while the Allied navies *totally cut off* the Central Powers.



The U.S. was neutral, but with the Central Powers cut off, Americans traded only with the Allies, who paid *any* price for war materiel...



Then in early 1917, the Russians overthrew their tsar, but stayed in the war.

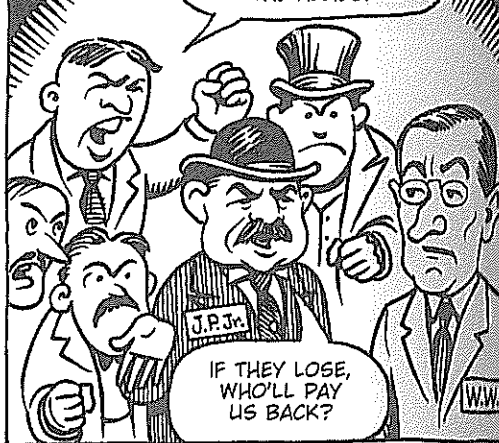


Russia's democracy didn't last; in late 1917, Lenin, who we last saw on page 64, took over (and pulled out of WWI).



And so:

**WE MUST HELP
THE ALLIES!**



Now the Allies were all *democracies*, while the Central Powers were not. That was the sort of war President Wilson could support.

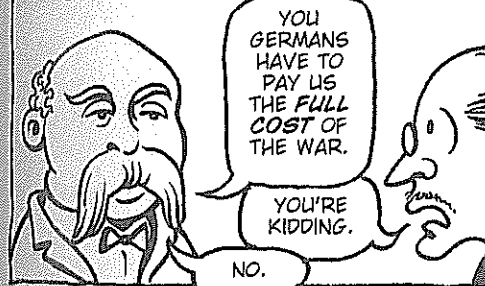
"THE WORLD MUST BE
MADE SAFE FOR DEMOCRACY!"



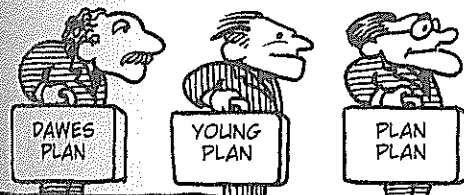
But it was too late for the Central Powers. Hungry and exhausted, they gave up in late 1918.



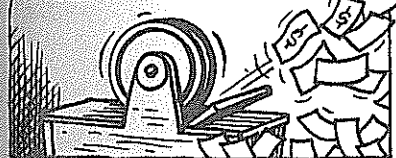
WWI left a world of problems; the punitive Treaty of Versailles (1919) made things worse.



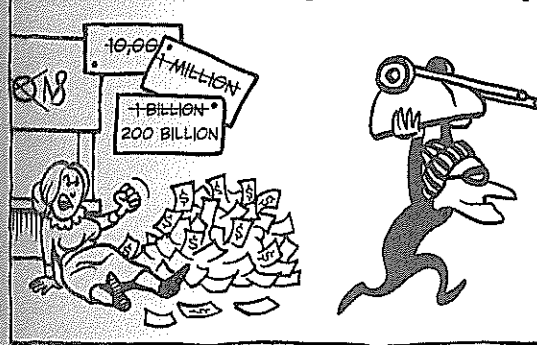
The Allies never got most of the money, but not for lack of trying. They came up with plan after plan to keep Germany paying. Under one plan, Germany would have been paying until 1988.



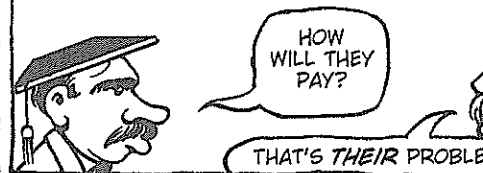
Germany tried to deal by **printing** extra money, then more, then more. All that money caused **inflation** (called that because when money loses its value, **prices** inflate).



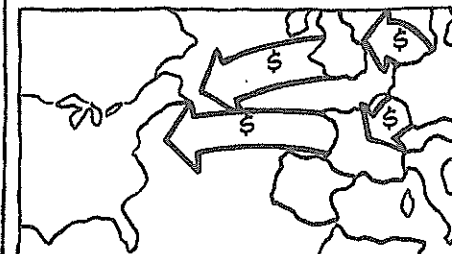
Cash wasn't worth saving, or even *stealing*.



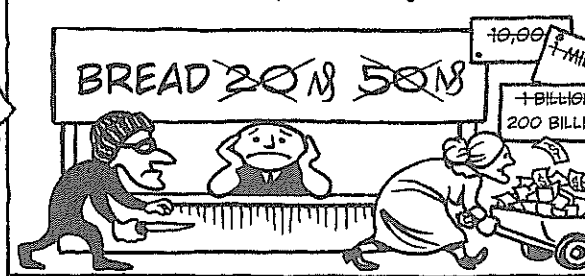
In *The Economic Consequences of the Peace* (1919), John Maynard Keynes (1883-1946), a young British economist, tried to explain that Germany could earn the money only by **exporting goods**, while the Allies were also crippling German exports.



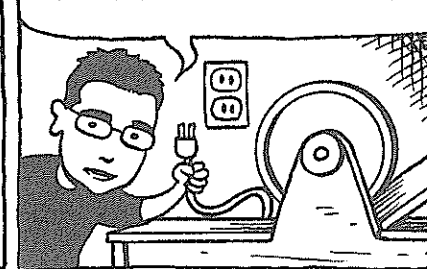
France and Britain couldn't forgive Germany's debt because the U.S. wouldn't forgive theirs.



At some point people lost faith in money, and without faith, money is nothing.



GERMANY FINALLY STOPPED THE
INSANITY IN LATE 1923 BY ABANDONING
ITS CURRENCY, PRINTING A NEW ONE
AND NOT PRINTING TOO MUCH OF IT



BIG PLANS

nother consequence of WWI: People saw the incredible **power** of the industrial economy when it's **directed**.

REMEMBER WHAT WE ACHIEVED WHEN WE ALL FOLLOWED A PLAN?

MOUNTAINS OF DEAD?

WELL, YEAH, BUT WHAT IF THAT EFFORT WENT TO SOMETHING GOOD, LIKE HOSPITALS OR SCHOOLS?

But in a democracy, it's hard to keep people cooperating when there's no war.

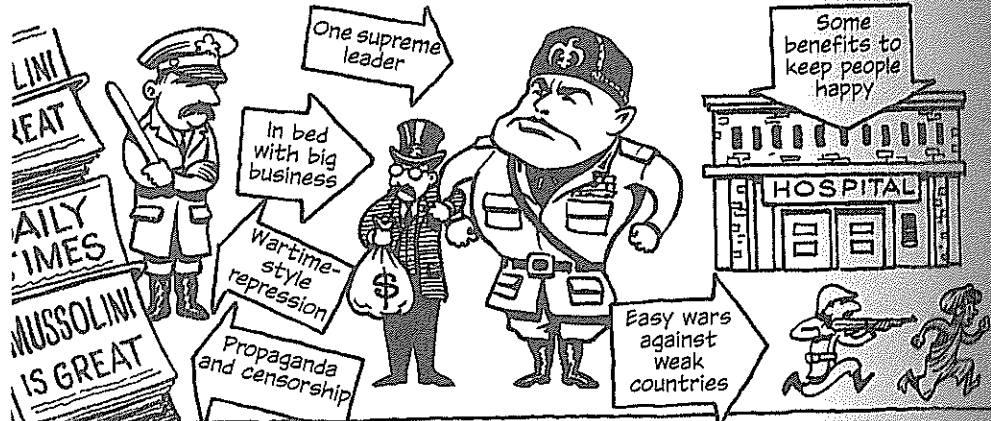
YOU'RE MOVING TO ROME TO WORK IN AN ORPHANAGE.

BITE ME.

"ALL WITHIN THE STATE, NOTHING OUTSIDE THE STATE, NOTHING AGAINST THE STATE!"

Benito Mussolini, an ex-socialist who took over Italy in 1922, had a solution: get rid of democracy.

Mussolini called his solution, which was a sort of permanent war economy, **Fascism**.



Today we see Mussolini as a bozo, but back then he seemed modern and dynamic. Dictators took over country after country in the 1920s. And not just capitalist countries.

REDS: The Russian Revolution and the Soviet State

Back to Russia: Lenin took over back on page 98. But what was supposed to happen after the revolution?

IT'S NOT IN HERE!

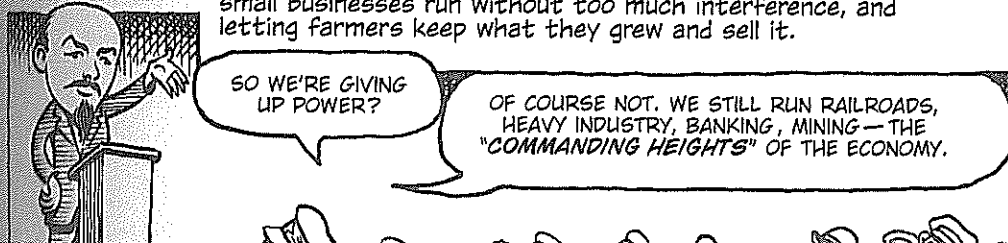
Capital

Engels had said the **state** would **with**er away under communism, but Lenin liked power, and anyway he couldn't relax while half of Russia, helped by the rest of the world, was trying to get rid of him (the **Russian Civil War**).

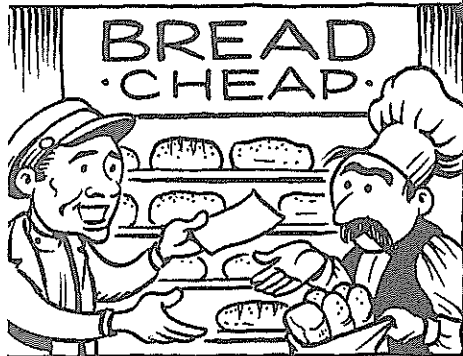
So Russian-style "communism" came to mean a **war economy**, complete with squashed dissent...



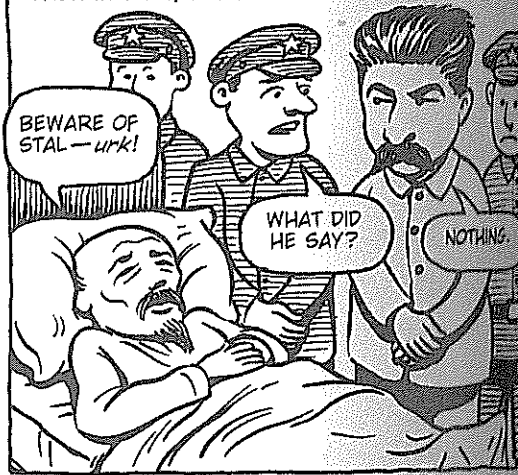
In 1921 Lenin did something unusual for a revolutionary: he **backpedaled**, letting small businesses run without too much interference, and letting farmers keep what they grew and sell it.



Lenin's "New Economic Policy" was a mixed economy, and mixed economies work. The Union of Soviet Socialist Republics (the country's new name) got on its feet.



Then in 1924, Lenin died.



Several top communists wanted to succeed Lenin; **Joseph Stalin** (1878-1953), a top party official, won.



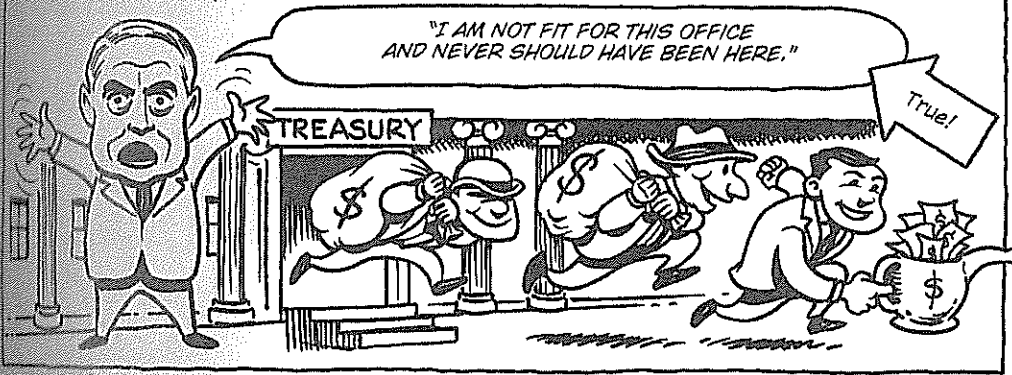
We'll get back to Stalin later; for now, we'll just note that the mere survival of a communist state *inspired* people all over the world...



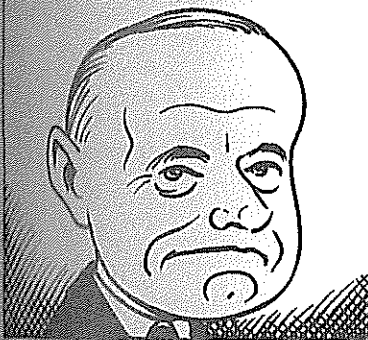
and *scared the bejesus* out of other people all over the world.

THE REVENGE OF WALL STREET

In the U.S., a post-WWI **red scare** helped establish a new conservative mood and give the 1920 presidential election to Warren Harding. Harding was a Republican, but he was no Teddy Roosevelt.



Harding died in office in 1923. His vice president and successor, Calvin Coolidge, was no more fit for the presidency than Harding had been, but he didn't say so.



In fact, "Silent Cal" barely said, or did, anything. The banker Andrew Mellon (page 76), now secretary of the Treasury, ran things. "Three presidents served under Mellon," people used to say.



Mellon's program: transferring the contents of the Treasury to himself and his friends.



President Coolidge didn't even try to stop the corruption, but his idleness looked like wisdom as a **boom** got rolling.

(A few pages are skipped. Now we will pick up after the depress has begun + FDR ...)

THE SECOND DEPRESSION

By 1936 the economy was humming again, and FDR easily won reelection.



FDR never liked deficit spending, and now he cut back.



Business didn't pick up the slack; the result was a second depression, or a second dip in the main Depression.



AS LATE AS 1939, UNEMPLOYMENT WAS OFFICIALLY 17%. THAT SOUNDED WORSE THAN IT WAS—PEOPLE WITH WPA AND CCC JOBS WERE COUNTED AS "UNEMPLOYED" FOR SOME REASON—BUT STILL, WHILE THE NEW DEAL EASED THE DEPRESSION, IT NEVER FIXED IT.

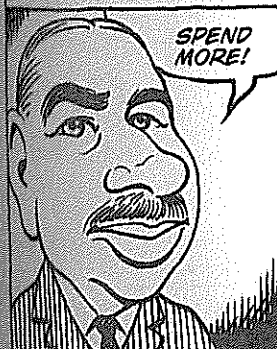


This is an important economist who proposed a new way to escape the Great Depression

THINGS FALL APART (1914-1945)

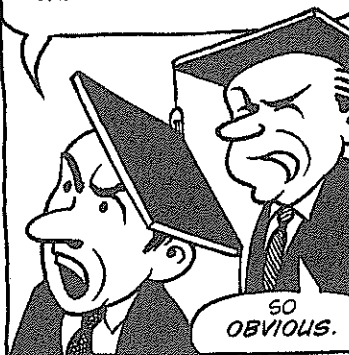
RETURN TO REALITY: Keynes and the General Theory

That someone was John Maynard Keynes, who we last saw on page 99. Keynes's key idea was simple: In slumps, spending falls, so to cure a slump:



That was an old, common-sense idea. But most economists had ignored it.

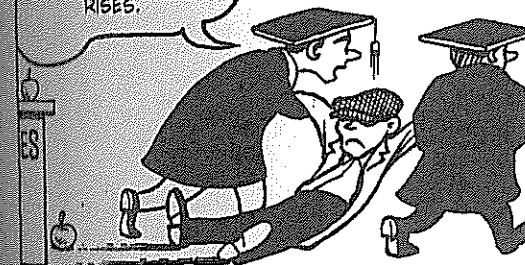
ONLY A SIMPLETON WOULD SAY SOMETHING SO... SO...



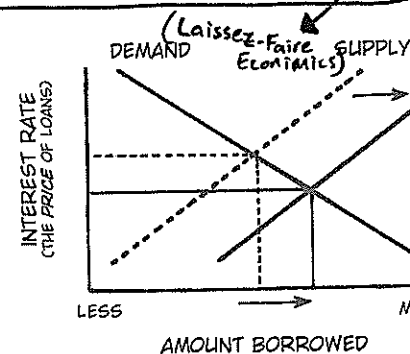
WE ALREADY KNOW WHAT TO DO ABOUT SLUMPS. NOTHING!



HERE'S THE PROOF. WHEN SPENDING FALLS, THE MONEY THAT ISN'T SPENT IS SAVED, SO THE SUPPLY OF LOANABLE FUNDS RISES.



WITH MORE SUPPLY, THE PRICE OF LOANS—THE INTEREST RATE—FALLS.



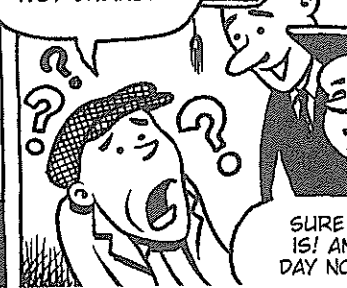
LOW INTEREST LEADS TO MORE INVESTMENT: IF YOU HAVE AN INVESTMENT THAT WILL PAY 5% A YEAR, YOU WON'T BORROW MONEY FOR IT AT 7% INTEREST, AND YOU WILL AT 3%.



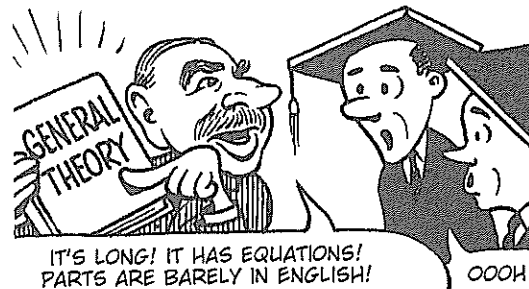
SO LESS SPENDING MEANS MORE SAVING, WHICH MEANS MORE INVESTMENT, WHICH IS JUST ANOTHER FORM OF SPENDING. AND SO SPENDING GOES BACK UP AND THE SLUMP ENDS!

That logic convinced many people and baffled most of the rest.

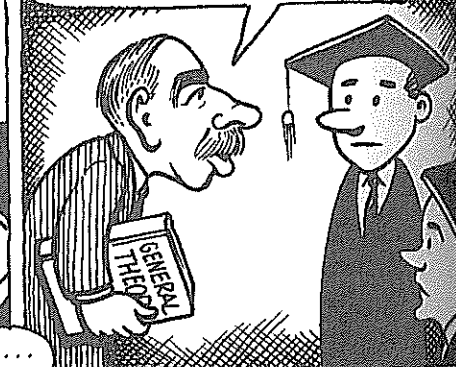
BUT THE DEPRESSION'S NOT ENDING....



It Keynes had learned orthodoxy from Fred Marshall himself, and then he'd *learned* it. In *The General Theory of Employment, Interest, and Money* (1936), Keynes showed why the "proof" we just saw was wrong, in economists' own language.



THE PROBLEM WITH YOUR LOGIC: YOU CAN ISOLATE ONE PART OF THE ECONOMY ON A **BLACKBOARD**, BUT NOT IN THE REAL WORLD.



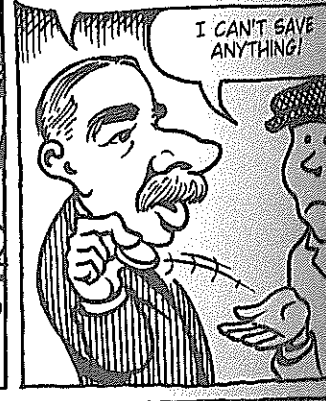
REMEMBER, A SUPPLY-AND-DEMAND CHART WORKS ONLY IF YOU **ASSUME** THAT PRETTY MUCH EVERYTHING NOT REPRESENTED ON THE CHART—TASTES, INCOMES, AND SO ON—REMAINS THE SAME.



BUT IN THE REAL WORLD, ONE PERSON'S SPENDING IS ANOTHER PERSON'S **INCOME**.



SO WHEN SPENDING FALLS, **INCOMES FALL, TOO**. HOW WILL PEOPLE SAVE MORE WITH **LESS** INCOME?



AND ANYWAY, WHO **INVESTS** WHEN NOBODY'S **SPENDING**?

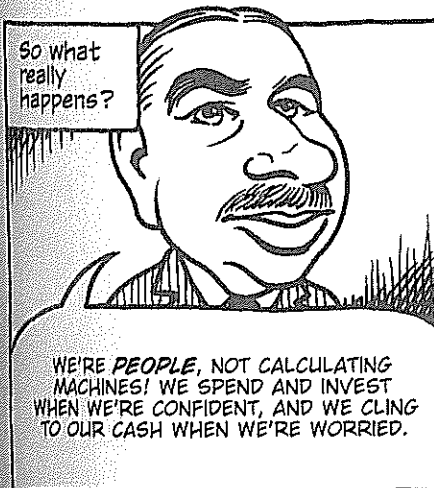
INTEREST RATES ARE DOWN! LET'S BORROW MONEY TO EXPAND OUR FACTORY!

EXPAND IT? WE'RE ABOUT TO CLOSE IT.



So what really happens?

WE'RE **PEOPLE**, NOT CALCULATING MACHINES! WE SPEND AND INVEST WHEN WE'RE **CONFIDENT**, AND WE CLING TO OUR CASH WHEN WE'RE **WORRIED**.



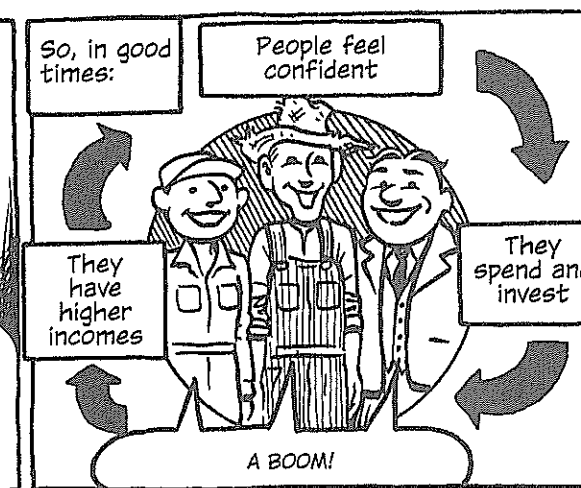
So, in good times:

People feel confident

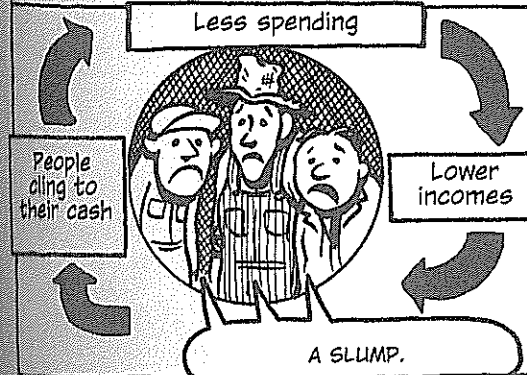
They have higher incomes

They spend and invest

A BOOM!



If spending is interrupted—by a bank panic, a stock crash, or people just deciding to save more—we get a **liquidity trap**. Liquidity basically means cash. In a liquidity trap nobody can **get** cash because everyone **wants** cash.

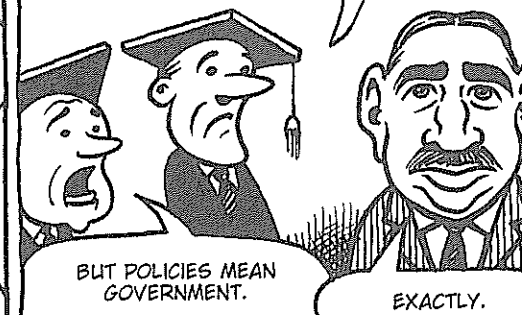


Before Keynes, economists thought that disappearing money would lead to lower prices and a new equilibrium. To Keynes, disappearing money led to **more** disappearing money, faster than prices could adjust. Prices are **sticky**—they tend to stick where they are because businesses can't easily cut their costs, like **wages**.

All of which meant that a slump **could** turn around at any time, but there was no reason it **had** to.



Keynes's ideas were plausible; more important, **policies** based on them were put to the test.



Keynes said government could **counter** the business cycle by doing the **opposite** of everyone else.

THE
GOVERNMENT
SHOULD ACT
CRAZY!

In a slump, Keynes said to pump up the economy with **deficit spending**.

In a boom, tax **more** and spend **less**, refilling the treasury and deflating 1920s-style lunacy.

THIS THINKING WAS
NEW TO MOST ECONOMISTS,
BUT FDR WAS ALREADY
DEFICIT SPENDING.

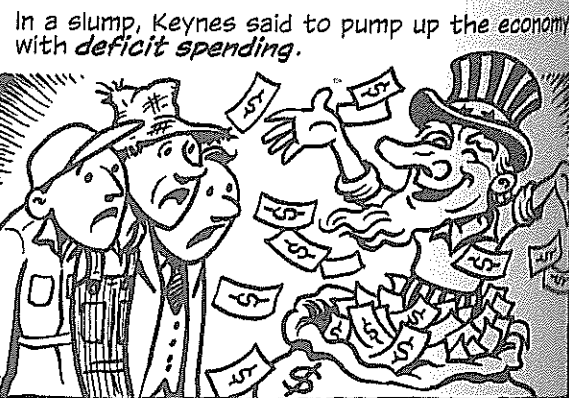
BECAUSE I
IGNORE ECONOMISTS!

THEN WHY WON'T THE
DEPRESSION END?

COME ON, ALREADY!

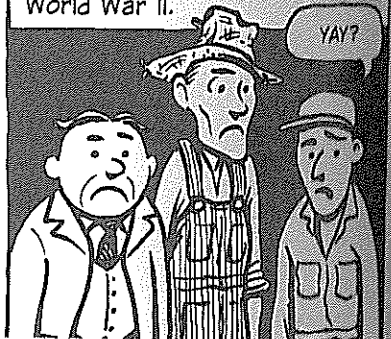
Keynes's answer: FDR hadn't spent enough. Keynes recommended a **full-employment deficit**, a level of spending that would result in a deficit even if everyone had a job and paid taxes. Even **wasteful** spending would be better than nothing, because the workers and suppliers would **re-spend** the money they earned on useful things.

BUILD PYRAMIDS IF
YOU HAVE TO!



Little did anyone know a big
spending project was on the way:
World War II.

YAY?



World War II had many causes; the worldwide Depression was a big one. Hard times don't just change interest rates and employment numbers; they **drive people nuts**.



But looting cost more and brought in less than just buying. And the Japanese army's brutality provoked **international embargoes**.

NOW WE NEED EVEN MORE
RESOURCES.



MAYBE
WE
SHOULD ATTACK
SOMEONE ELSE?

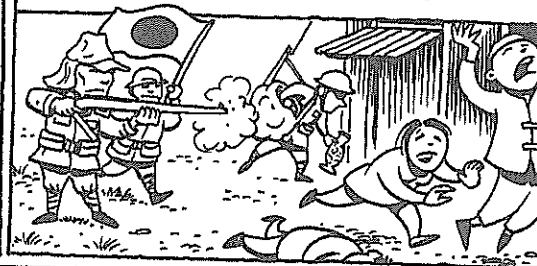
The Chinese
communists were
stuck in the hills,
far from the
workers in the
cities.



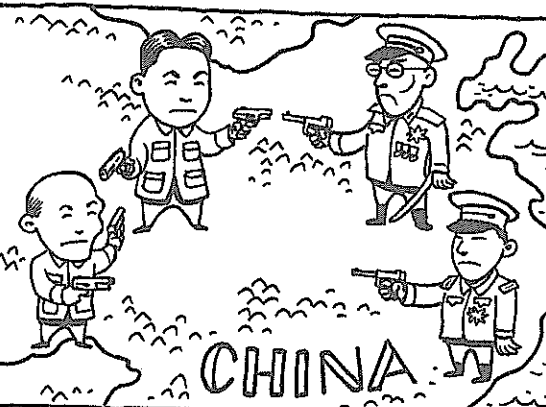
MAKES IT HARD TO
HAVE A WORKERS'
REVOLUTION.

THE WORLD UNHINGED

In the 1930s, collapsing trade hit **Japan**, who traded for almost everything, especially hard. The Japanese government fell apart; the army out of control, attacked China to get resources.



Plus, Japan never fully conquered China. The Chinese leader, Chiang Kai-shek (1887-1975), held out, and some Chinese **communists** survived, led by one Mao Zedong (1893-1976).



With nothing else to do, the communists organized nearby **farmers**. The only capital that mattered in the Chinese countryside was **land**, so sharing capital meant dividing the land, also known as **land reform**. That was simple and practical once the landlord's objections were overcome.

YOU WORK THE SAME FIELD YOU ALWAYS HAVE, BUT
NOW YOU KEEP WHAT YOU GROW INSTEAD OF
GIVING IT TO THE LANDLORD.

MAY HE REST IN PEACE.



Maoist land reform
didn't resemble anything
imagined by Karl Marx.
Neither did what was
going on in the USSR

We last saw the U.S.S.R. as Joseph Stalin consolidated power in the late 1920s. At the time, Soviets needed industrial goods, but the industrialized West wouldn't *trade* with commies, at least not openly.



The U.S. didn't even recognize the U.S.S.R. until 1933.

If you can't trade for something, you might as well make it.

WE'LL INDUSTRIALIZE!



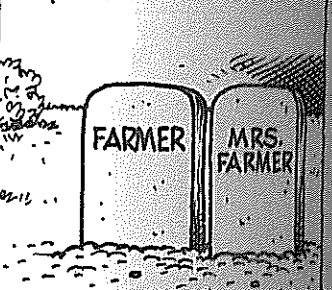
Stalin's plans undid Lenin's New Economic Policy (page 102). The state took charge of the whole economy. In the countryside, farmers lost their land to big collective farms.

THEY'RE COMING FOR THE COW NEXT WEEK.

OR, WE COULD EAT IT.



Farmers who resisted were "liquidated."

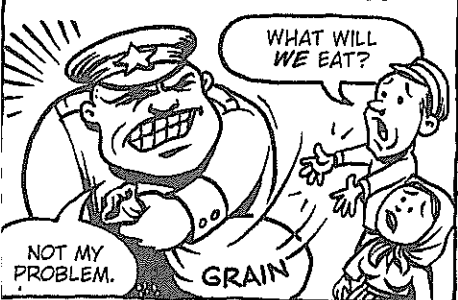


The collective farms didn't produce as much as the old private ones, but Stalin's workers still had to eat.

WHAT WILL WE EAT?

NOT MY PROBLEM.

GRAIN



Millions of people starved to death in the fertile Ukraine between 1932 and 1933.

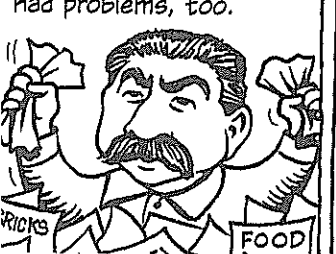


Stalin's industrial plans went better, but they had problems, too.

As things went wrong, instead of *backing off* like Lenin had (page 101), Stalin tried to control *more*, which led to more problems, and so on. Soon Stalin suspected *sabotage*.

He started *executing engineers*, which didn't help.

EVERYONE IS AGAINST ME!



By the late 1930s, nobody in the U.S.S.R. was safe. Millions of people were plucked from their homes to live out their short, wretched lives in labor camps.

WHAT ARE YOU IN FOR?

NOBODY WILL TELL ME.

WHY WON'T YOU COOPERATE?

So if the U.S.S.R. didn't exactly suffer from the Depression, it suffered all the same.



The truth about Stalin got out, but many Western lefties ignored or excused it.

"THE LABOR CAMPS HAVE WON HIGH REPUTATIONS... AS PLACES WHERE TENS OF THOUSANDS OF MEN HAVE BEEN RECLAIMED."

—ANNA LOUISE STRONG, JOURNALIST AND ACTIVIST

Part of the reason: Our brains *can't process* crimes on this scale, and Stalin knew it.

"A SINGLE DEATH IS A TRAGEDY."

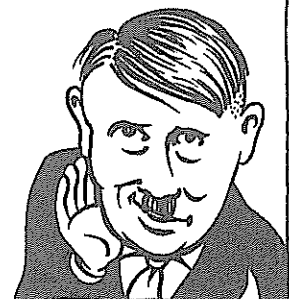
"A MILLION DEATHS IS A STATISTIC."

"TO TRAVEL FROM THE CAPITALIST WORLD INTO SOVIET TERRITORY IS TO PASS FROM DEATH TO BIRTH."

—JOHN STRACHEY, POLITICIAN

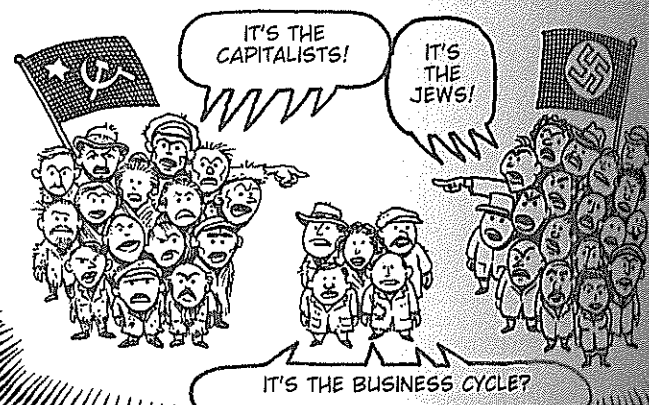


A German right-wing crazy, Adolf Hitler, knew it, too.



"[PEOPLE] MORE READILY FALL VICTIM TO THE BIG LIE THAN THE SMALL LIE."

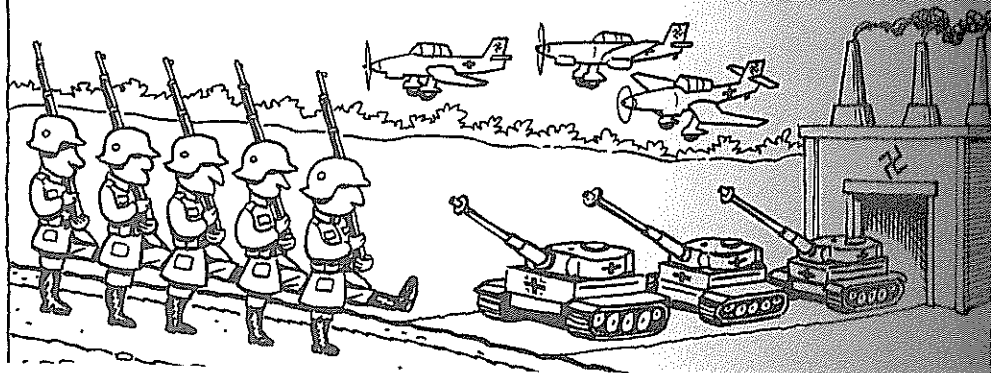
And in Depression-era Germany, where unemployment reached an unbearable 40%, crazies thrived like infections in a weakened body.



Hitler and his *National Socialist* party (*Nazi* for short) took power in early 1933. The Nazi program did have some socialist elements:

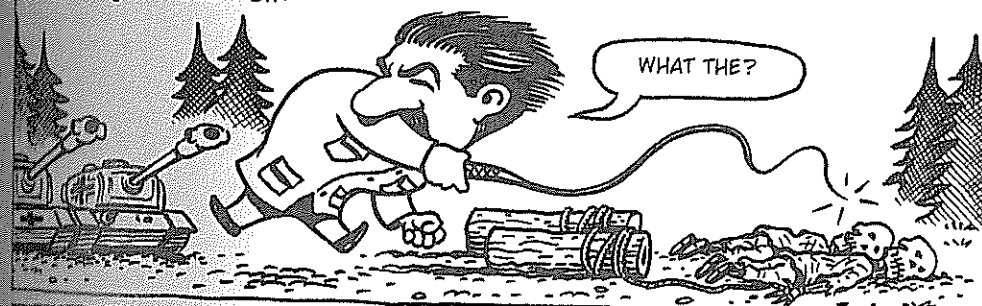


But the nationalism came first. Hitler wanted a *rematch* of WWI, which brings us back to:

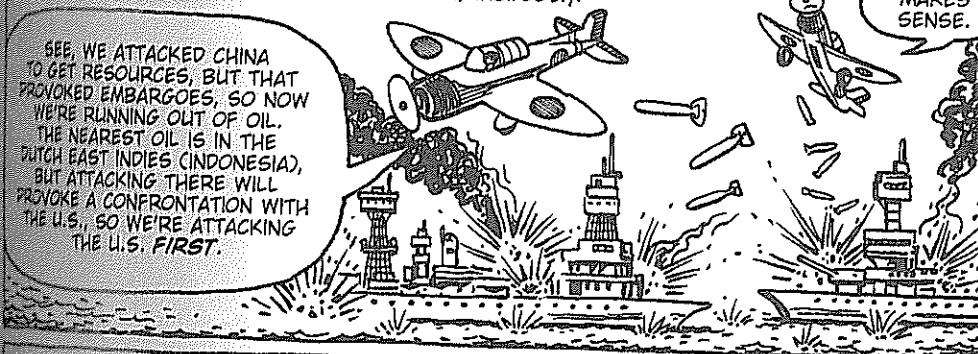


WORLD WAR II

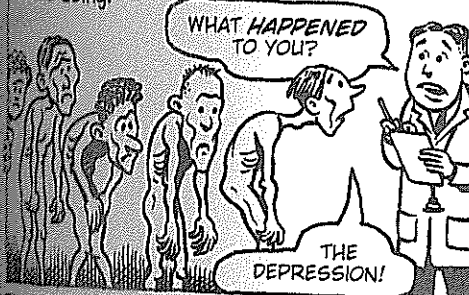
The war started in 1939 and went global in 1941: First Hitler attacked the U.S.S.R., partly to get Russia's oil.



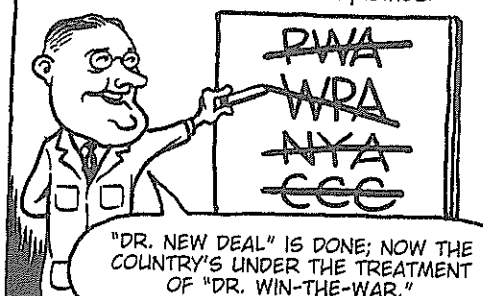
Then Japan attacked the U.S., also for oil, indirectly.



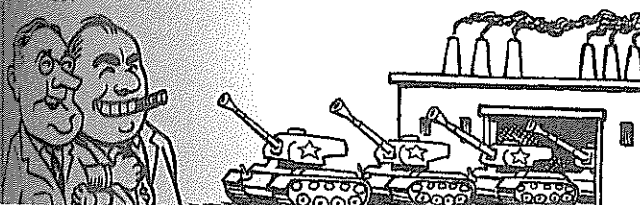
Getting the U.S. on a war footing took some doing.



And the New Deal? FDR explained:



Dr. Win-the-War *liked* big business. The unemployed disappeared into the factories and the army, and the American economy, idled for so long, showed what it could do.



Germany fell in early 1945; Japan not long after.

